

**MANAGEMENT DISCUSSION AND ANALYSIS AND
FINANCIAL STATEMENTS
DECEMBER 31, 2006 AND 2005**



**DICKINSON
COUNTY
HEALTHCARE
SYSTEM**

(A COMPONENT UNIT OF DICKINSON COUNTY)

IRON MOUNTAIN, MICHIGAN

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type <input type="checkbox"/> County <input type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Unit Name Dickinson County Healthcare System	County Dickinson
Fiscal Year End 12/31/06	Opinion Date 04/05/07	Date Audit Report Submitted to State	

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

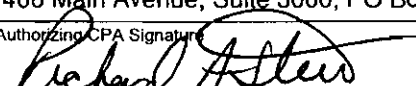
YES NO

Check each applicable box below. (See instructions for further detail.)

1. ☒ ☐ All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2. ☒ ☐ There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3. ☐ ☐ The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4. ☒ ☐ The local unit has adopted a budget for all required funds.
5. ☒ ☐ A public hearing on the budget was held in accordance with State statute.
6. ☒ ☐ The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7. ☐ ☐ The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8. ☒ ☐ The local unit only holds deposits/investments that comply with statutory requirements.
9. ☒ ☐ The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10. ☒ ☐ There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11. ☒ ☐ The local unit is free of repeated comments from previous years.
12. ☒ ☐ The audit opinion is UNQUALIFIED.
13. ☒ ☐ The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14. ☒ ☐ The board or council approves all invoices prior to payment as required by charter or statute.
15. ☒ ☐ To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)	
Financial Statements	<input checked="" type="checkbox"/>		
The letter of Comments and Recommendations	<input checked="" type="checkbox"/>		
Other (Describe)	<input type="checkbox"/>		
Certified Public Accountant (Firm Name) Eide Bailly LLP		Telephone Number 701.239.8500	
Street Address 406 Main Avenue, Suite 3000, PO Box 2545		City Fargo	State ND
		Zip 58108	
Authorizing CPA Signature 	Printed Name Richard A. Steen, CPA		License Number 1101029379

DICKINSON COUNTY HEALTHCARE SYSTEM

Table of Contents

	<u>Page</u>
INDEPENDENT AUDITOR'S REPORT	1
MANAGEMENT'S DISCUSSION AND ANALYSIS	3
FINANCIAL STATEMENTS	
Balance Sheets	20
Revenues, Expenses, and Changes in Net Assets	21
Cash Flows	22
Notes to Financial Statements	24



INDEPENDENT AUDITOR'S REPORT

The Board of Trustees
Dickinson County Healthcare System
Iron Mountain, Michigan

We have audited the accompanying balance sheets of **Dickinson County Healthcare System** (a component unit of Dickinson County) as of December 31, 2006 and 2005, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Healthcare System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only **Dickinson County Healthcare System** and are not intended to present fairly the financial position of Dickinson County, Michigan, and do not reflect the results of its operations and cash flows of its proprietary funds in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of **Dickinson County Healthcare System** as of December 31, 2006 and 2005, and the results of its operations, changes in net assets, and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 1 through 19 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on management's discussion and analysis.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 5, 2007, on our consideration of **Dickinson County Healthcare System's** internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Eide Bailly LLP

Fargo, North Dakota
April 5, 2007

DICKINSON COUNTY HEALTHCARE SYSTEM
(A Component Unit of Dickinson County)
MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2006, 2005, AND 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of Dickinson County Healthcare System's (Healthcare System's) financial performance provides an overview of financial activities for the fiscal years that ended on December 31, 2006, 2005, and 2004. This financial report is designed to provide our local citizens, customers, and creditors with a general overview of the System's finances and to demonstrate the System's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Healthcare System's Financial Offices, 1721 S. Stephenson Avenue, Iron Mountain, Michigan, 49801.

FINANCIAL HIGHLIGHTS

Year Ended December 31, 2006

- The Healthcare System's net assets increased in 2006 by \$1.9 million, or 5.7% with income before capital contributions of \$1.9 million, comprised of operating income of \$3.3 million less non-operating expenses in excess of revenue of \$1.4 million, plus \$8 thousand of capital contributions for the annual addition in total Net Assets.
- During 2006, the Healthcare System's total operating revenues increased by \$3.8 million or 6.0% over the \$62.9 million in 2005, while expenses of \$63.4 million in 2006 were 5.1% above the \$60.4 million in 2005. The resulting operating income for 2006 was 4.9% of total operating revenue compared to 4.1% in 2005.
- The construction of the addition to the hospital facility, which was opened in 2005, allowed for the consolidation of cardiac rehabilitation with other components of the rehabilitation department near the front lobby for patient convenience and efficiency purposes, and it also provided space for additional conference rooms in the lower level. In turn that opened up space that had been used for those functions in the Dickinson Medical Building (DMB), which is connected to the hospital, for several enhancements to our services there in 2006:
 - Pediatrics Clinic – The recruitment of a new, second pediatrician to join the clinic together with its move to a newly constructed suite in the DMB from its prior cross-town location improved patient service and convenience with closer proximity to the newborn nursery and pediatrics inpatient units.
 - Upper Peninsula Sleep Disorder Center – An additional sleep study area was constructed in this suite in the DMB to keep up with increasing patient volumes.
 - Internal Medicine/Nephrology Clinic – The recruitment of a new, second physician for this practice also located in the DMB enhanced coverage of the Renal Dialysis and Critical Care units and increased availability for consults on inpatients.
- The Healthcare System continued its commitment to investing in information technology in 2006:
 - Begun in 2004, the implementation of a replacement hospital information system is a continuing project that includes the capability for an enterprise-wide electronic medical record scheduled to go live in the third quarter of 2007. It also includes modules for patient finance, registration, scheduling, hospital electronic medical records and nursing documentation. Operating efficiencies are anticipated.

- In 2006, a project was begun that upgrades the digital transcription system with voice recognition and other enhancements to permit electronic document production. In addition to reducing the turn-around time for document completion, it permits remote access for physicians and the medical transcriptionists who will edit the documents for final approval and electronic signature. This will be brought live in 2007, in connection with the electronic medical record project. A separate module will permit the radiologists to complete and sign their own electronic reports, integrated with their workflow in the radiology system and with the electronic medical record.
- Begun in 2005, the picture archiving and communications system (PACS) was completed and additional modules for orthopedics and nuclear medicine were added. Image conversion from a prior system was also completed. Significant savings in film costs were realized. Ultimately, the substantial space for film storage will be recovered for other productive uses and the labor intensive cost of retrieving and re-filing historical film studies will be eliminated. The system has the ability to serve as the repository of images from other clinical departments as well to provide additional savings in years to come.

Years Ended December 31, 2005 and 2004

- The Healthcare System's net assets increased in 2005 by \$1.2 million, or 3.7% with income before capital contributions of over \$1 million, comprised of operating income of \$2.6 million less non-operating expenses in excess of revenue of \$1.6 million, plus \$197 thousand of capital contributions. In 2004 the net asset increase was \$238 thousand or 0.7%.
- During 2005, the Healthcare System's total operating revenues increased to \$62.9 million or 4.0% over the \$60.5 million in 2004, while expenses of \$60.4 million in 2005 were 2.7% above the \$58.8 million in 2004. The resulting operating income for 2005 was 4.1% of total operating revenue compared to 2.8% in 2004.
- The 2005 Income before capital contributions was \$1.0 million compared to \$130 thousand in 2004. The non-operating investment income, excluding the unrealized amounts, increased \$181 thousand in 2005 from the prior year's earnings due to reductions in investments for capital expenditures and higher total returns. The July 2005 completion of the major construction of the addition to the hospital facility caused 2005 interest expense to increase by \$59 thousand over the 2004 expense because of the capitalization of related financing costs during the planning and construction period, which included most of 2004. Other non-operating revenue includes contributions and the loss on sale of capital items. Unrestricted general contributions were \$53 thousand in 2005 compared to \$125 thousand received in the prior year and the loss on the disposal of capital equipment was \$113 thousand more than that in 2004.
- During 2005 and 2004, the Healthcare System enhanced and expanded services to the community through the following successful initiatives and other significant expenditures on capital projects:
 - The recruitment of an Urologist in cooperation with BellinHealth of Green Bay, Wisconsin brought the ability to do new, minimally invasive procedures, including laser treatment of kidney stones and new methods to treat cancer.
 - The recruitment of an additional orthopedic surgeon filled the gap in this service, which had required the Healthcare System to enter into costly contracts with distant surgeons for temporary periods of coverage in the prior year.

- The expanded imaging services through the new MRI brought the ability to perform advanced exams that are quieter, of better quality and which provide the option of feet-first exams. Opened July 5, 2005, the increased number of exams through the last half of the year is indicative of the community's need and support of this service. The additional investment in the 16,800 square foot addition to the facility also enhanced and consolidated physical rehabilitation services, which also saw increases in patient volumes.
- The major project to replace the hospital information system was begun in 2005 and is scheduled for completion in 2007.
- Other information technology projects were completed in 2005, including the installation of a storage area network with a separate disaster recovery site and installation of a digital physician dictation system.
- A project to provide filmless imaging services through the use of a picture archiving and communications system (PACS) with an ultrasound and other computerized radiography interfaces and a radiology information system was 80% complete by year-end.
- Installed a second CT scanner in 2004 and commenced construction of a major two-story addition to the DCMH facility to house a Fixed MRI and relocate rehabilitation services and other departments.
- Completed the project to replace the General Financial, Materials Management and Human Resources systems in 2004.

The source of funding for capital projects was derived from the proceeds of a \$5 million debt issue in August 2004 and from current and prior years' operations and capital contributions from the public through the Dickinson County Hospital Foundation. No government funding from taxes or any other source was used for capital or operating purposes.

REQUIRED FINANCIAL STATEMENTS

The Basic Financial Statements of the Healthcare System report offers short-term and long-term financial information about its activities and financial status.

The *Balance Sheet* includes all of the Healthcare System's assets, liabilities and net assets. It provides information about the nature and amounts of cash, receivables and investments in resources (assets) and the obligations to creditors (liabilities) at the end of each year presented. It also provides the basis for evaluating the debt and capital structure, and assessing the liquidity and financial flexibility of the Healthcare System. A summary table of this statement is presented later in this discussion and analysis.

All of the annual revenues and expenses are accounted for in the *Statement of Revenues, Expenses, and Changes in Net Assets*. This statement measures the annual financial performance of the Healthcare System's operations over the past two years and can be used to determine whether all of its paid and accrued costs have been covered by patient service revenue and other revenue sources that were received or receivable with an excess or a deficit for each year. A summary table of this statement is presented later in this discussion and analysis.

The final required financial statement is the *Statement of Cash Flows*. The primary purpose of this statement is to provide information about the Healthcare System's cash provided by or used in its operating, financing, and investing activities in each of the last two years, and to show the cash on hand at the beginning and end of the two preceding annual periods.

FINANCIAL ANALYSIS OF THE SYSTEM

The condensed *Balance Sheets* of the Healthcare System as of December 31, 2006, 2005, and 2004 are summarized in the following table.

CONDENSED BALANCE SHEETS DECEMBER 31, 2006, 2005, AND 2004 (in thousands)

	2006	2005	2004
Total current assets (includes the current portion of restricted assets)	\$ 18,555	\$ 15,522	\$ 19,204
Cash and investments internally designated for capital acquisitions	7,089	10,171	10,748
Cash and investments internally designated for other purposes	4,104	1,070	1,404
Cash and investments restricted by bond indentures	2,086	3,774	5,416
Deferred financing costs, net	275	299	324
Capital assets, net	45,728	45,604	41,635
TOTAL ASSETS	\$ 77,837	\$ 76,440	\$ 78,731
Total current liabilities	\$ 9,520	\$ 8,880	\$ 11,352
Long-term debt, net of current portion	31,359	32,384	33,343
Other long-term liabilities	951	1,055	1,138
TOTAL LIABILITIES	41,830	42,319	45,833
TOTAL NET ASSETS	36,007	34,121	32,898
TOTAL LIABILITIES AND NET ASSETS	\$ 77,837	\$ 76,440	\$ 78,731

Assets and Liabilities:

Assets represent the resources of the Healthcare System and liabilities its obligations. Net assets are the resources available to provide benefits in the future.

Current Assets are principally comprised of cash and receivables. Net patient accounts receivable represented 46.0 days' of net revenue at December 31, 2006 compared to 42.0 at December 31, 2005 and 42.4 at December 31, 2004. The increase is attributable to the fact that the Healthcare System experienced an increase in privately-insured patients with higher deductibles and co-insurance, resulting in more receivables from patients after insurance payments were applied. Such balances take longer to collect. There was also a staffing shortage in December 2006 that caused a slight delay in coding the medical record, which delays the billing to Medicare and other insurance companies; however as of February 28, 2007 the patient accounts receivable were down to 42.0 days' revenue.

The number of days of total cash and investments was 125.6 at December 31, 2006, 131.2 at December 31, 2005, and 177.2 at December 31, 2004. This ratio shows how total funds compare to daily cash operating expenses plus interest expense.

The total cash and investments at December 31, 2006 were \$21.2 million including restricted funds for debt service of \$3.3 million. The remaining proceeds from an August 2004 debt issue which was restricted by the loan indenture for capital assets was expended during 2006. Total cash and investments at December 31, 2005 were \$21.1 million including restricted funds of \$3.6 million expendable for debt service and \$1.4 million of unexpended proceeds from the August 2004 debt issue. Total cash and investments at December 31, 2004 were \$27.9 million including \$3.4 million of funds expendable for debt service and \$3.2 million of unexpended proceeds from the August 2004 debt issue. Excluding the restricted amounts, the ratios for 2006, 2005, and 2004 were 105.8 days, 100.1 days, and 135.4 days respectively. Cash improved in 2006 because more cash was provided from operations than in the prior year, and 2006 capital expenditures were lower than the amount spent in 2005. The principal causes of the reduction of cash and investments in 2005 were the planned capital expenditures and the payback of amounts to third-party payers in the ordinary course of the settlement process.

Current Liabilities at December 31, 2006 are 2.5% higher than December 31, 2005 because of three principal reasons: 1. The accruals for salaries and wages and compensated absences increased due to higher average salaries; 2. Estimated third-party payer settlements increased due to higher reimbursement amounts for 2006 and the net changes in the status of prior years' estimates; and 3. Current maturities of long-term debt increased due to higher principal payments.

The Healthcare System's current liabilities at December 31, 2005 were substantially lower than December 31, 2004 due to status of estimated settlements with third-party payers. Estimated settlements payable (principally to Blue Cross, Blue Shield of Michigan) were down a total of \$2.3 million because of a payback in 2005 of approximately \$1.9 million of amounts routinely paid for services in 2004. A favorable outcome related to a Medicare settlement for a prior year caused an additional reduction in the estimated liability.

The Healthcare System's current ratio (current assets divided by current liabilities) is 1.99 at December 31, 2006, 1.71 at December 31, 2005, and 1.69 at December 31, 2004.

Long-Term Debt:

The Healthcare System had long-term debt of \$31.4 million at December 31, 2006, \$32.4 million at December 31, 2005, and \$33.3 million at December 31, 2004 (net of current maturities of \$1.3 million in 2006 and \$1.2 million in 2005 and 2004). The Healthcare System issued Hospital Revenue Bonds, Series 2004 in the amount of \$5 million for capital projects to be completed in 2005 and 2006. The payments on the Series 2004 debt-issue are made monthly with a 25-year term. Long-term debt represents 97.1% of the Healthcare System's total long-term liabilities and 75.7% of total liabilities at December 31, 2006 as compared to 96.8% and 76.5% at December 31, 2005 and 96.7% and 72.7% at December 31, 2004.

The debt service coverage ratio for the years ended December 31, 2006, 2005, and 2004 was 2.56, 2.24, and 1.95 respectively. This ratio shows how the sum of income before capital contributions (adjusted for unrealized gains or losses on investments and before deducting depreciation and interest expense) compares to the total cash paid for debt service (principal plus interest) in the applicable year. The improvements in this ratio for 2006 and 2005 are the result of higher income from operations in each of those years.

Components of Net Assets (in thousands):

		December 31,	
	2006	2005	2004
Invested in capital assets, net of related debt	\$ 13,362	\$ 12,305	\$ 7,096
Restricted by Revenue Bond Indentures, expendable for capital assets	-	1,412	3,220
Restricted by Revenue Bond Indentures, expendable for debt service	3,186	3,411	3,194
Unrestricted	19,459	16,993	19,388
Total net assets	\$ 36,007	\$ 34,121	\$ 32,898

The overall increase in net assets in 2006 was due to operating income and capital contributions. The changes in the components can be explained as follows. The amount invested in capital minus all capital related debt increased in 2006 due to the capital expenditures, less the annual depreciation, which resulted in a net increase in capital assets for the year, and the payment of principal, which decreased the related debt. The restricted amount for capital asset acquisitions in 2005 represented the unexpended portion of the proceeds from the August 2004 debt issue. The remaining amount at the end of 2005 was spent for capital projects in 2006. The restricted amount for debt service represents the funds held by the trustee for the Series 1999 bonds, and this amount decreased due to the reduction in the related debt service requirements. Unrestricted net assets increased due to the excess of income, capital contributions plus annual depreciation over the total of capital expenditures from unrestricted funds plus required deposits to the restricted funds for debt service.

The overall increase in net assets in 2005 is due to operating income and capital contributions. The restricted amount for capital assets represented the unexpended portion of the proceeds from the August 2004 debt issue. This amount will be spent for capital projects in 2006. The restricted amount for debt service represents the funds held by the trustee for the Series 1999 bonds, and this amount increased because one extra monthly payment was made to the Principal and Interest Fund in 2005. This was handled as a pre-payment against the 2006 payments. Unrestricted net assets decreased due to the purchase of capital assets and the required deposits to the restricted funds for debt service.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

The condensed statements of revenues, expenses, and changes in net assets of the Healthcare System for the years ended December 31, 2006, 2005, and 2004 is summarized in the following table.

**CONDENSED STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2006, 2005, AND 2004 (in thousands)**

	2006		2005		2004	
REVENUE AND (EXPENSES):						
Net patient service revenue	\$	66,122	100.0%	\$	62,400	100.0%
Other revenue		555	0.8%		541	0.9%
Total operating revenue		66,677	100.8%		62,941	100.9%
Total operating expenses		63,411	95.9%		60,352	96.7%
OPERATING INCOME		3,266	4.9%		2,589	4.1%
Investment income		992	1.5%		911	1.5%
Change in unrealized gains and losses on investments		(21)	0.0%		(180)	-0.3%
Interest expense		(2,298)	-3.5%		(2,210)	-3.5%
Other non-operating revenue and expenses (net)		(61)	-0.1%		(84)	-0.1%
Non-operating expenses in excess of revenue		(1,388)	-2.1%		(1,563)	-2.5%
INCOME BEFORE CAPITAL CONTRIBUTIONS		1,878	2.8%		1,026	1.6%
CAPITAL CONTRIBUTIONS		8			197	
INCREASE IN NET ASSETS		1,886			1,223	
NET ASSETS - BEGINNING OF YEAR		34,121			32,898	
NET ASSETS - END OF YEAR	\$	36,007		\$	34,121	
						\$ 32,898

SOURCES OF FINANCIAL SUPPORT

The Healthcare System relies upon its revenues and public contributions received directly or through the Dickinson County Hospital Foundation for 100% of its financial support. No tax revenue is received either directly from local taxpayers or through fund transfers from Dickinson County or other governments. Revenue is comprised of operating revenue, which is principally from healthcare services and non-operating revenue which is principally from investment income.

Operating Revenue:

Net patient revenue is reported as the result of subtracting estimated contractual allowances, provisions for charity care and the provision for bad debts from gross revenue recorded at our established rates. Total gross revenues for all patient services performed by the Healthcare System were \$152.4 million in 2006, \$141.9 million in 2005, and \$132.3 million in 2004. The overall increases in 2006 include the impact of price increases of 4.5% for hospital services and physician practices on January 1, 2006. The 2005 gross revenue increase was impacted by price increases of 9% for hospital services and 5% for physician practices on February 1, 2005. The 7.4% total increase in gross charges in 2006 and the 7.3% increase in 2005 also reflect the year-to-year differences in patient volumes, as presented in the Operating Results discussion in a later section. Gross revenue is based upon the services provided at our established rates. To the extent the Healthcare System receives payment under fixed rates by third-party payers as explained below, the price increase has a diminished effect on net patient revenue.

The services performed under contractual arrangements with Medicare, Michigan Medicaid, Blue Cross Blue Shield of Michigan and other contractual payers are recorded on the day of service at the established charges of the Healthcare System. In order to determine net patient service revenue, provisions for contractual allowances are recorded to recognize deductions from revenue resulting from contractual allowances under various reimbursement arrangements. These provisions, including adjustments for prior years' settlements, give rise to the amount included in current liabilities as a net payable, which decreased significantly in 2005 and increased slightly in 2006.

Management maintains systems and procedures to administer and comply with the payment contracts and files cost reports on an annual basis. The reimbursement methods include payer audits and reviews of cost reports and individual claims that sometimes result in adjustments to amounts previously paid, additional payments, or denial of payment. Management applies estimates to provide for these payment and adjustments, and it continually reviews and adjusts those estimates until all reimbursement for a given year has been finalized.

The Healthcare System provides care without regard to the ability to pay. Free or reduced-rate care is provided based on family income. For the years ended December 31, 2006, 2005, and 2004, the Healthcare System deducted approximately 1.0%, 0.8%, and 0.7% respectively, from its gross charges for services provided to patients who documented their inability to pay. Collection efforts are pursued if the bills for services are not paid and qualification for free or reduced-rate care has not been established. Some portion of the resulting bad debt adjustment also includes free care to persons who would have qualified for free or reduced-rate care had they provided documentation of income.

Bad debt provisions were 2.5% of gross charges in 2006, 2.4% in 2005, and 2.3% in 2004. Management estimates the allowance for doubtful accounts by applying percentages to an aged trial balance of accounts collectible from patients, and includes provisions to account for balances currently due from insurance companies that may be subsequently denied with the ability to collect from the patient in doubt.

The resulting net patient services revenue (Gross revenue minus free care allowance and contractual allowances and minus the provision for bad debt expense) was 43.4% of gross revenue in 2006, 44.0% in 2005, and 45.3% in 2004. Net patient services revenue increased \$2.4 million or 4.1% from 2004 to 2005 and \$3.7 million or 6.0% from 2005 to 2006 due to the remaining net effect of price increases, net improvement in third-party payment rates, the additional payments received for prior years' cost report settlements, and the slight decline in overall patient volumes in 2004 and 2005 as presented in the Operating Performance section of this discussion.

Nonoperating Revenue:

Investment income was \$992 thousand for 2006, \$911 thousand for 2005, and \$730 thousand for 2004. The increase in investment income in 2006 is due to the timing of withdrawals of investments for capital expenditures and other purposes during 2005 and in 2004, and also the effect of higher yields on the fixed income securities and money market accounts which comprise our investments. All cash in excess of daily operating requirements is invested. Because of favorable money market rates and the inverted yield curve in latter 2006, more cash is held in current assets than had been done at the prior year-ends. The investment manager considers the cash flow budgets and plans of the Healthcare System as well as the underlying market conditions in decisions to purchase and sell bonds issued by or backed by the full faith and credit of the United States of America. Management and the Board of Trustees monitor the investment manager performance. The bond portfolio has a conservative duration, and management does not foresee a need to sell any of the bonds at a loss. However, the investments are adjusted to fair value, and the resulting unrealized gain or loss is reflected in the present period. The unrealized losses on investments were \$21 thousand in 2006, \$180 thousand in 2005, and \$235 thousand in 2004.

Capital Contributions:

Capital contributions received during 2006 of \$8 thousand consist of donations to the Healthcare System for several small equipment purchases for the dialysis and cardiac rehab departments. Capital contributions received during 2005 of \$197 thousand were for the Fixed MRI unit, upgrades to enable cardiac echo procedures and laser treatments and continuous blood glucose monitoring systems. Fiscal year 2004 capital contributions of \$108 thousand were received for emergency department equipment and a laboratory information system component.

EXPENDITURE OF FUNDS***Operating Expenses:***

The components of operating expenses for the Healthcare System for the years ended December 31, 2006 and 2005 is summarized in the following table:

**COMPONENTS OF OPERATING EXPENSES
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005 (in thousands)**

	2006	2005	Increase/ (Decrease)	
Salaries, wages and employee benefits	\$ 40,044	\$ 37,983	\$ 2,061	5.4%
Supplies and pharmaceuticals	8,273	7,843	430	5.5%
Professional fees and other purchased services	10,941	10,696	245	2.3%
Depreciation and amortization	4,152	3,830	322	8.4%
Total	<u>\$ 63,410</u>	<u>\$ 60,352</u>	<u>\$ 3,058</u>	<u>5.1%</u>

Employee compensation and benefits increased \$2,061 thousand or 5.4%. The overall activity of the Healthcare System, as measured by patient discharges adjusted for outpatient services and all other patient revenue, increased 2.6% to 12,788 adjusted discharges for 2006 compared to 12,463 adjusted discharges in 2005. The annual average full-time equivalent positions for 2006 increased by 2.4% from the 2005 average, resulting in a very slight decrease in paid man-hours per adjusted discharge to 102.3 in 2006 from 102.5 in 2005. Two Unions represent approximately 64% of total employees. An agreement with one of the Unions was successfully negotiated and recently signed. Three-year agreements are in effect through May 2008 and December 2009.

Salaries, wages and benefits have been maintained on a competitive basis, and no critical shortages of labor have been experienced.

The cost of supplies and pharmaceuticals increased \$475 thousand or 6.1%. Adjusting the cost for changes in volumes, supplies per adjusted discharge (inpatient discharges plus a factor for outpatients) increased only 3.4% due to normal inflation.

Professional fees, purchased services and other expenses for 2006 increased \$245 thousand or 2.3% due to normal inflation.

Depreciation and amortization expense for 2006 increased \$276 thousand or 7.1%, principally due to the full year effect of the building addition and MRI placed in service in mid 2005

The components of operating expenses for the Healthcare System for the years ended December 31, 2005 and 2004 is summarized in the following table:

**COMPONENTS OF OPERATING EXPENSES
FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004 (in thousands)**

	2005	2004	Increase/ (Decrease)	
Salaries, wages and employee benefits	\$ 37,983	\$ 37,325	\$ 658	1.8%
Supplies and pharmaceuticals	7,843	7,787	56	0.7%
Professional fees and other purchased services	10,696	10,290	406	3.9%
Depreciation and amortization	3,830	3,414	416	12.2%
Total	<u>\$ 60,352</u>	<u>\$ 58,816</u>	<u>\$ 1,536</u>	<u>2.6%</u>

Employee compensation and benefits increased \$658 thousand or 1.8%. The annual average full-time equivalent positions for 2005 increased by 1.2% from the 2004 average. Productive hours per adjusted discharge increased 2.3%, which is caused by the patient volume decline relative to some required minimum or fixed staffing levels. Two Unions represent approximately 64% of total employees. Salaries, wages and benefits have been maintained on a competitive basis, and no critical shortages of labor have been experienced.

The cost of supplies and pharmaceuticals decreased \$11 thousand or 0.1%. This was normal inflation net of usage reductions due to lower patient volumes.

Professional fees, purchased services and other expenses for 2005 increased \$406 thousand or 3.9%. Significant increases included the following areas where fees were higher than in 2004: Equipment and software maintenance contracts increased \$245 thousand while temporary coverage in the Pediatrics Clinic increased \$199 thousand and medical professional fees of \$189 thousand for Urology were incurred. Significant decreases included: In 2004, the Healthcare System elected to provide coverage by paying fees to orthopedic surgeons on a temporary basis due to changes in the practices of local surgeons. A new surgeon was recruited to the area and began covering services locally in 2005. The expense provision related to professional claims deductibles decreased significantly in 2005.

Depreciation and amortization expense for 2005 increased \$461 thousand or 13.5%, principally due to the completion of the building addition and purchase of the fixed MRI unit.

Non-operating Expense Items:

Interest expense was \$2.3 million in 2006 and 2.2 million per year in 2005 and 2004. There was no change in debt structure during 2006 and 2005. The Healthcare System capitalized \$18 thousand and \$171 thousand of interest expense related to the construction of the building addition in 2006 and 2005 respectively.

Capital Expenditures:

Fiscal Year 2006

Total capital expenditures were reduced to \$4.5 million in 2006, including construction and renovation costs of \$563 thousand down from the total expenditures of \$8.1 million in 2005, which had the principal costs of constructing the hospital facility building addition of \$3.9 million and the \$1.8 million equipment cost of the new MRI.

The 2006 construction and renovation costs completed the building addition and the renovation of suites in the Dickinson Medical Building. The major hospital information system project costs were \$1.3 million in 2006 compared to \$500 thousand in 2005. The hospital information system replacement project, including the hospital electronic medical record system and other principal modules, is scheduled to go live in the third quarter of 2007. Other 2006 capital spending includes other information technology projects including expenditures for digital dictation, enhancements to the picture archiving and communications system (PACS) to add additional modalities and routine equipment replacements in other departments.

Fiscal Year 2005 and 2004

Total capital expenditures were \$8.1 million in 2005 due to the major costs of the building addition and MRI, compared to \$5.3 million in 2004.

During 2005, the Healthcare System completed the construction of the addition that had broken ground in 2004. The two-story addition houses a new fixed MRI unit that replaced a mobile unit and provides expanded space for physical rehabilitation services, permitting consolidation of its cardiac rehabilitation program formerly housed in the Dickinson Medical Building. Projects to furnish and equip the expanded Imaging and Physical Rehab areas in the addition were also completed.

Major medical imaging technology projects that commenced in 2004 included the addition of a multi-slice CT scanner at a cost of \$988 thousand that became operational in May of 2004, a fixed site MRI unit that became operational in July 2005 at a cost of \$1.8 million and a picture archiving and communications system (PACS) and radiology information system (RIS) with a projected completion date in 2006. Of the anticipated PACS/RIS cost of \$1.4 million, approximately \$818 thousand was expended in 2005. As part of the project to move toward filmless procedures, a related computerized radiography project was completed in 2005 at a cost of \$286 thousand.

Major upgrades to information technology have been carried out since 2002 and are ongoing. The project to replace core elements of the hospital information system for billing, hospital electronic medical records, order communications, registration, nursing documentation and pharmacy commenced in 2005 with an expected go live date in 2007. Costs incurred in 2005 were \$500 thousand. The enterprise resource procurement system replaced components of the present hospital information system in the areas of materials management, human resources and fiscal services in 2004 at a cost of \$1.8 million incurred over a two and one-half year period.

Renovations in the Dickinson Medical Building for the Pediatric Clinic and the Upper Peninsula Sleep Center also commenced in 2005 with completion expected the first quarter of 2006. Costs incurred in 2005 were \$197 thousand with additional expenditures of \$232 thousand expected in 2006 to include both construction and furnishings.

OPERATING RESULTS

The following summarizes the operating results of the Healthcare System and its business units as reflected in the Statements of Revenue, Expenses, and Changes in Net Assets.

Dickinson County Healthcare System:

Fiscal Year 2005 to 2006

The overall increase in operating income was due to the higher patient volumes, favorable payment rates, favorable prior-year settlement payments, and good control of expenses relative to patient volumes. Given the 2.6% increase in adjusted discharges, a comparative analysis of revenue and expenses per adjusted discharge for 2006 compared to 2005 is as follows. Patient revenue before the bad debt provision per adjusted discharge was \$5,473 in 2006, a 3.6% increase from 2005. Operating expenses adjusted to include the bad debt provision and interest expense per adjusted discharge was \$5,440 in 2006, a 2.7% increase from 2005.

Fiscal Year 2004 to 2005

The overall activity of the Healthcare System, as measured by patient discharges adjusted for outpatient services and all other operating revenue, showed a slight decrease from the prior year. Adjusted discharges for 2005 were 12,463 compared to 12,705 adjusted discharges in 2004. This was a decrease of 1.9%. The adjusted discharge statistic is used as the means to measure the overall activity volume of the Healthcare System. Patient revenue before the bad debt provision per adjusted discharge was \$5,282 in 2005, a 6.6% increase from the 2004 amount of \$4954. Operating expense per adjusted discharge including the bad debt provision and interest expense was \$5,295 in 2005, a 5.2% increase from the 2004 amount of \$5,033 due to a high percentage of fixed costs such as depreciation and interest. Despite the overall decrease in patient volumes, operating income increased significantly. This was largely due to the control of overall expenses.

Dickinson County Memorial Hospital:

Fiscal Year 2005 to 2006

Inpatient activity levels at the Dickinson County Memorial Hospital (DCMH) facility for 2006 comprised about 35% of net patient revenue of the Healthcare System. Total patient days and discharges of acute inpatients were 13,989 and 3,745, respectively in fiscal year 2006. This is a decrease of 6.7% and 4.0%, respectively, from fiscal year 2005.

Total outpatient visits at DCMH were 162,130, or 2.4% above 2005 levels. In mid-2005 the new MRI began serving patients, replacing a mobile unit, and the public open house of the new building addition received much attention in the community. The fixed site MRI services and expanded physical rehabilitation areas in the new building addition contributed significantly to outpatient volumes in both 2006 and 2005. MRI procedures increased 3.4% in 2006 and 8.0% in 2005. DCMH outpatient services are approximately 61.2% of gross patient revenue of the Healthcare System and contribute a positive contribution margin toward operating income.

Operating income from DCMH increased substantially in 2006 from that in 2005.

Fiscal Year 2004 to 2005

Inpatient activity levels at the Dickinson County Memorial Hospital (DCMH) facility for 20065 comprised about 36.7% of net patient revenue of the Healthcare System. Total patient days and discharges of acute inpatients were 14,991 and 3,901, respectively in fiscal year 2005. This is a decrease of 2.1% and 3.5%, respectively, from fiscal year 2004.

Total outpatient visits at DCMH were 158,287, or 6.3% above 2004 levels. This follows three years of declining outpatient visits after dramatic annual growth rates through 2001 since the new facility opened in 1996. In mid-2005 the new MRI began serving patients, replacing a mobile unit, and the public open house of the new building addition received much attention in the community. We believe that the fixed site MRI services and expanded physical rehabilitation areas in the new building addition contributed significantly to this turn-around in 2005. Outpatient visits for recurring services (such as physical rehabilitation) of all the patient visit types showed the largest percentage increase of 13.8% in 2005. MRI procedures increased 11.5% in 2005. DCMH outpatient services are 64.8% of gross patient revenue of the Healthcare System and contribute a positive contribution margin toward operating income.

Physician Services and Other Operating Units:

Fiscal Year 2005 to 2006

Total visits to physicians at the Healthcare System's clinics and physician practices increased 12.1% in 2006 to 44,142 from 39,382 in 2005. The number of productive physician and mid-level practitioners increased from 7.2 in 2005 to 8.7 in 2006, an increase of 19.4%. In total, the Physician Services component unit contributes slightly more than 5% of patient revenue of the Healthcare System. The clinic and physician practice expenses exceeded their operating revenue in 2006, but the inpatient admissions and outpatient services ordered by these practitioners, contribute greatly to sustaining the hospital's operations.

Dickinson Home Health (DHH) saw 437 patients in 2006, or 2.9% more than 2005 levels. This decrease is in line with the decrease of hospital discharges. There were no other significant changes in operations in 2006. On a combined basis, these activities contributed to operating income in both 2006 and 2005, and they comprise approximately 3% of patient revenue of the Healthcare System.

The Upper Peninsula Sleep Center contributes only 0.8% of net patient revenue, but does contribute significantly to income of the Healthcare System in 2006. The DCHS unit is the only sleep center accredited by the American Academy of Sleep Medicine in the upper peninsula of Michigan, and was staffed by 5 certified diagnostic technologists in 2006 (100% of the staff).

Fiscal Year 2004 to 2005

Total visits to physicians at the Healthcare System's clinics and physician practices were steady at 39,382, or 1.3% above 2004 levels. In total, the Physician Services component unit contributes slightly more than 4.8% of patient revenue of the Healthcare System. The clinic and physician practice expenses exceeded their operating revenue.

Dickinson Home Health (DHH) saw 450 patients in 2005, or 27% more than 2004 levels. The closing of Dickinson/Iron County Home Health had a substantial impact on DHH operations, especially in the areas of skilled nursing and physical therapy. Staffing levels were increased in several areas and there is still work in progress to meet the needs of these patients. Dickinson Home Medical Equipment (DHME), which shares the location and management of DHH operations, also increased total revenue in 2005 as a result of increased community awareness and from efforts to establish agreements with extended care facilities to provide oxygen and related equipment to their clients. On a combined basis, these activities contributed to operating income in both 2006 and 2005, and they comprise slightly more than 3.2% of patient revenue of the Healthcare System.

The Upper Peninsula Sleep Center contributes 0.8% of net patient revenue and contributed to income of the Healthcare System in 2005. The DCHS unit is the only sleep center accredited by the American Academy of Sleep Medicine in the upper peninsula of Michigan, and was staffed by five certified diagnostic technologists in 2005 (100% of the staff).

OPERATIONS IMPROVEMENT AND STRATEGIC PLANNING

2006 Activities:

The Board and management continue to seek ways to increase market share for the Healthcare System and area physicians through ongoing joint planning with hospital systems that provide tertiary care for our primary service area. Our plans are to continue to recruit local specialty physicians to provide care at our facility and to cooperate and share programs with tertiary care partners to our north and south. Discussions are underway between local primary care physicians, the Healthcare System and BellinHealth in Green Bay, Wisconsin, regarding cooperative efforts to combine and organize physician practice operations. Continued successes from these plans are required to maintain or improve market share for primary care service lines in our service area.

The Healthcare System is a member of the Upper Peninsula Healthcare Network (UPHCN) along with Marquette General Health System in Marquette, Michigan, whose interests are aligned to help retain primary care in Dickinson County and meet the tertiary care needs of that market within Michigan. The Upper Peninsula Health Plan (UPHP) is owned by UPHCN members and has developed an alliance with Blue Cross Blue Shield of Michigan to provide a network of Michigan providers. The Healthcare System currently uses that network for its employee health plan.

The Healthcare System is also a member of the PPL Network, a managed care network owned by BellinHealth in Green Bay, Wisconsin, and other providers to give insurance plans and employers throughout northeastern Wisconsin access to a network of physicians and hospitals. Most of the primary care physicians on the medical staff of the Healthcare System are members of that network. In addition to participating as network providers, PPL Network physicians gain certain other management services and cost savings opportunities.

A quality management program to improve inpatient case management and documentation, reduce lengths of stay and to avoid unnecessary consumption of hospital resources while maintaining good outcomes and patient satisfaction has been in place since 2003. This continuous process is ongoing to ensure that proper documentation and coding standards are maintained to ensure proper reimbursement. Management continues to monitor physician documentation, lengths of stay, resource consumption and care planning through nurse case managers and independent physician reviewers.

2005 Activities:

Management successfully carried out projects to implement the urology and orthopedic surgeon practices in 2005. The recruitment process was successful in providing necessary specialties of Pediatrics, Interventional Radiology and Internal Medicine/Nephrology in 2005 with practices to be established in 2006. The longer-term planning for primary care physician transition and retirements also received primary attention in 2005.

Overall surgical volumes declined. While urology and orthopedics were a major factor that was addressed by the successful recruiting efforts, Management also took steps with general surgeons to enhance outpatient procedure volumes by establishing a "direct access" endoscopy program to expedite the referral process. A further investment of \$250 thousand for scopes and scope light service also represents the Healthcare System's commitment to turning around the loss of market share in this service area.

The strategies to be part of both the UPHCN and the PPL Network are intended to enhance the market share of both the Healthcare System and local specialists by retaining primary care physician referrals while ensuring access to tertiary services. As these relationships and the networks develop in the local market, Management believes that cost savings opportunities for employers in our Michigan and Wisconsin service areas will be enhanced.

2004 Activities:

In 2004, physician recruitments were successful in key areas such as orthopedics and urology, the latter through a joint agreement with Bellin Health System in Green Bay, Wisconsin.

CURRENT BUDGET

As required by the Bylaws, Management prepares an annual budget for the approval of the Board of Trustees of the Healthcare System. The Current Budget as approved consists of an operating budget, a cash flow budget and a three-year capital budget together with the capital plan that identifies the source of funds for capital financing.

The operating budget is presented in a format similar to the *Statement of Revenues, Expenses, and Changes in Net Assets* (except that the provision for bad debts is budgeted as an operating expense instead of as a reduction from revenue) and the cash flow budget is submitted in a format similar to the *Statement of Cash Flows*. Operating statistics that serve as assumptions underlying the financial amounts in the budgets are also budgeted. On a monthly basis, actual financial and statistical amounts are compared to budgeted amounts and variances are monitored and controlled.

CONDENSED STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET ASSETS ACTUAL COMPARED TO BUDGET YEAR ENDED DECEMBER 31, 2006 (in thousands)

	Actual	Budget	Variance*	
REVENUE AND (EXPENSES):				
Net patient service revenue	\$ 69,987	\$ 70,070	\$ (83)	-0.1%
Other	555	551	4	0.7%
Total operating revenue	70,542	70,621	(79)	-0.1%
Total operating expenses	67,276	68,350	1,074	1.6%
OPERATING INCOME	3,266	2,271	995	43.8%
Investment income, including unrealized gains and losses on investments and other items (net)	910	860	50	5.8%
Interest expense	(2,298)	(2,291)	(7)	-0.3%
Non-operating expenses in excess of revenue	(1,388)	(1,431)	43	3.0%
INCOME BEFORE CAPITAL CONTRIBUTIONS	1,878	840	1,038	123.6%
OTHER CHANGE IN NET ASSETS:				
Capital contributions	8	35	(27)	-76.3%
Increase in net assets	1,886	875	\$ 1,011	115.5%
NET ASSETS - BEGINNING OF YEAR	34,121	33,022		
NET ASSETS - END OF YEAR	\$ 36,007	\$ 33,897	\$ 2,110	6.2%

*In the variance column of this table, a negative value (-) indicates an unfavorable variance to budget.

Net patient revenue was under budget by \$83 thousand or 0.1%. The inpatient volumes represented by acute adult and pediatric discharges were 6.8% below budget, while the length of stay improvement of 2.6% caused average daily census to be 8.1% under budget. Outpatient visits were 0.8% under budget. Favorable payment rates and prior-year settlement payments and adjustments brought the net revenue for the hospital into a favorable net revenue variance of \$486 thousand or 0.7%. Overall physician practice net patient services revenue was under budget \$569 thousand or 13.7%. The overall unfavorable physician services revenue variance was because of a 9.8% unfavorable variance in the number of visits compared to that anticipated in the budget, and a 6.8% unfavorable variance in the net revenue per visit. The budget anticipated the recruitment and employment of a Pulmonologist for a new practice in 2006. The fact that this additional operation did not come about accounts for 24% of the unfavorable variance in the number of visits.

Nonoperating revenue and expenses was favorable overall due to unrestricted contributions, 11.4% over budget and up 44.0% from the prior year because of increased donations from the United Way and the Hospital Foundation for the Lifeline Program, which provides home monitors for seniors, and unrestricted investment income was over budget by 16.7% and up 13.2% from the prior year because of the favorable cash provided by operations, the under-spending on capital equipment, slower than planned expenditures on construction and IT projects. Interest expense was over budget a slight 0.3% due to estimations in the budget.

**COMPONENTS OF OPERATING EXPENSES
ACTUAL COMPARED TO BUDGET
YEAR ENDED DECEMBER 31, 2006 (in thousands)**

	Actual	Budget	Variance*	
Salaries, wages and employee benefits	\$ 40,044	\$ 40,624	\$ 580	1.4%
Supplies and pharmaceuticals	8,273	8,342	69	0.8%
Professional fees and other purchased services	10,941	10,935	(6)	-0.1%
Depreciation and amortization	4,152	4,407	255	5.8%
Provisions for bad debts	3,865	4,042	177	4.4%
Total	<u>\$ 67,275</u>	<u>\$ 68,350</u>	<u>\$ 1,075</u>	<u>1.6%</u>

*In the variance column of this table, a negative value (-) indicates an unfavorable variance to budget.

Overall expenses are 1.6% under budget due to control of expenses relative to patient volumes. Employee compensation and benefit expense was under budget \$580 thousand or 1.4%. Total full-time equivalent employees were 629.0 compared to the budget of 629.5 for a favorable variance of 0.1%. The average budgeted salary per FTE was favorable by 0.6% and 4.1% higher than 2005. Management anticipates the need to maintain employee compensation in line with market forces in the future given the need to continue to recruit and retained a highly skilled labor force.

Supplies and pharmaceuticals were under budget \$69 thousand or 0.8%, primarily due to lower inpatient and outpatient surgery volumes than had been anticipate in the budget.

Depreciation and amortization expense was under budget by \$255 thousand or 5.8% due to less capital expenditure than planned and projects that were not placed into service as soon as planned.

The provision for bad debts was under budget \$177 thousand or 4.4% due to the unfavorable variance in patient service revenue.

CAPITAL BUDGET AND FINANCIAL PLAN

The three-year capital budget included plans for 2006 capital expenditures of \$5.0 million, including \$2.5 million on information technology projects. Actual spending was \$4.5 million in total, including \$2.4 million on IT projects, the completion of construction and renovations begun in 2004, equipment and furnishings of \$1.4 million and the remainder was spent on routine equipment purchases.

The sources of funding for the budgeted spending included the remaining \$1.4 million unexpended funds from the Hospital Revenue Bonds, Series 2004 that were issued in August 2004 in the amount of \$5 million. Those funds were used to complete the hospital addition and other construction, related furnishings and equipment and other equipment projects. The Foundation provided \$8 thousand (?) for equipment and furnishings in the Dialysis Unit and the Cardiac Rehabilitation Department. The remainder of the capital spending was from working capital generated by operations.

DICKINSON COUNTY HEALTHCARE SYSTEM
(A Component Unit of Dickinson County)
BALANCE SHEETS
DECEMBER 31, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 6,383,477	\$ 2,312,852
Temporary investments	258,199	2,544,596
Current portion of restricted assets	1,256,346	1,214,440
Receivables		
Patient, net of estimated uncollectibles of		
\$2,681,000 in 2006 and \$2,265,000 in 2005	8,335,902	7,180,234
Other	154,851	177,229
Supplies and other current assets	2,166,481	2,092,315
Total current assets	<u>18,555,256</u>	<u>15,521,666</u>
NONCURRENT CASH AND INVESTMENTS		
Internally designated for capital improvements	7,088,984	10,170,625
Other long-term investments	4,103,694	1,070,196
Restricted under indenture agreement for debt service	2,085,897	2,361,138
Restricted under indenture agreement for capital assets	-	1,412,483
Total noncurrent cash and investments	<u>13,278,575</u>	<u>15,014,442</u>
CAPITAL ASSETS	<u>45,727,782</u>	<u>45,604,297</u>
DEFERRED FINANCING COSTS, net accumulated amortization		
of \$188,211 in 2006 and \$164,420 in 2005	<u>275,403</u>	<u>299,194</u>
Total assets	<u>\$ 77,837,016</u>	<u>\$ 76,439,599</u>

	<u>2006</u>	<u>2005</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Current maturities of long-term debt	\$ 1,281,924	\$ 1,214,435
Accounts payable		
Trade	1,894,565	1,627,876
Construction and capital assets	7,963	84,789
Estimated third-party payor settlements	1,428,105	1,308,767
Accrued expenses		
Salaries, wages, and related liabilities	1,631,236	1,478,174
Compensated absences	2,729,550	2,433,509
Other accrued liabilities	265,059	442,620
Interest	281,346	289,435
Total current liabilities	<u>9,519,748</u>	<u>8,879,605</u>
LONG-TERM LIABILITIES		
Long-term debt, less current maturities	31,358,773	32,384,321
Reserve for loss on general and professional liabilities claims	795,000	890,000
Other	156,070	164,820
Total long-term liabilities	<u>32,309,843</u>	<u>33,439,141</u>
Total liabilities	<u>41,829,591</u>	<u>42,318,746</u>
NET ASSETS		
Invested in capital assets, net of related debt	13,362,488	12,304,735
Restricted - expendable for debt service	3,186,173	3,410,758
Restricted - expendable for capital assets	-	1,412,483
Unrestricted	19,458,764	16,992,877
Total net assets	<u>36,007,425</u>	<u>34,120,853</u>
Total liabilities and net assets	<u>\$ 77,837,016</u>	<u>\$ 76,439,599</u>

DICKINSON COUNTY HEALTHCARE SYSTEM

(A Component Unit of Dickinson County)

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
OPERATING REVENUE		
Net patient service revenue, net of provision for bad debts of \$3,864,841 in 2006 and \$3,437,405 in 2005	\$ 66,121,952	\$ 62,400,012
Other revenue	554,769	540,924
Total operating revenue	<u>66,676,721</u>	<u>62,940,936</u>
OPERATING EXPENSES		
Salaries and wages	31,039,400	29,117,918
Employee benefits	9,004,864	8,864,949
Supplies and pharmaceuticals	8,272,521	7,842,857
Medical and other professional fees	2,250,336	2,136,778
Purchased services and other	8,690,747	8,559,267
Depreciation	4,152,445	3,830,350
Total operating expenses	<u>63,410,313</u>	<u>60,352,119</u>
OPERATING INCOME	<u>3,266,408</u>	<u>2,588,817</u>
NONOPERATING REVENUES (EXPENSES)		
Unrestricted general contributions and other	76,205	52,934
Interest and amortization expense	(2,298,080)	(2,210,218)
Loss on disposal of capital assets	(136,604)	(136,490)
Investment income	991,685	910,721
Change in unrealized gains and losses on investments	(21,321)	(179,718)
Total nonoperating revenues (expenses)	<u>(1,388,115)</u>	<u>(1,562,771)</u>
REVENUES IN EXCESS OF EXPENSES BEFORE CAPITAL CONTRIBUTIONS	1,878,293	1,026,046
CAPITAL CONTRIBUTIONS	<u>8,279</u>	<u>197,000</u>
INCREASE IN NET ASSETS	1,886,572	1,223,046
NET ASSETS, BEGINNING OF YEAR	<u>34,120,853</u>	<u>32,897,807</u>
NET ASSETS, END OF YEAR	<u>\$ 36,007,425</u>	<u>\$ 34,120,853</u>

DICKINSON COUNTY HEALTHCARE SYSTEM
(A Component Unit of Dickinson County)
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
OPERATING ACTIVITIES		
Receipts from and on behalf of patients	\$ 64,966,284	\$ 62,188,915
Receipts (payments) with third-party payors for settlements	119,338	(2,289,190)
Payments to suppliers and contractors	(28,002,465)	(28,379,735)
Payments to employees	(30,886,338)	(28,853,774)
Other receipts and payments	577,147	846,050
NET CASH FROM OPERATING ACTIVITIES	<u>6,773,966</u>	<u>3,512,266</u>
NONCAPITAL FINANCING ACTIVITY		
Unrestricted general contributions and other	76,205	52,934
CAPITAL AND CAPITAL RELATED FINANCING ACTIVITIES		
Purchase of capital assets, net	(4,521,423)	(8,088,159)
Repayment of long-term debt	(1,214,435)	(1,204,006)
Interest paid, including capitalized interest	(2,043,674)	(2,100,703)
Capital contributions	8,279	197,000
Proceeds from the sale of capital assets	49,735	59,651
NET CASH USED FOR CAPITAL AND CAPITAL RELATED FINANCING ACTIVITIES	<u>(7,721,518)</u>	<u>(11,136,217)</u>
INVESTING ACTIVITIES		
Purchases of investments	(6,901,903)	(7,168,091)
Proceeds from sales and maturities of investments	8,715,000	9,711,410
Investment income	982,935	901,971
NET CASH FROM INVESTING ACTIVITIES	<u>2,796,032</u>	<u>3,445,290</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>1,924,685</u>	<u>(4,125,727)</u>
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>5,136,789</u>	<u>9,262,516</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 7,061,474</u>	<u>\$ 5,136,789</u>
RECONCILIATION OF CASH AND CASH EQUIVALENTS TO THE BALANCE SHEETS		
Cash and cash equivalents in current assets	\$ 6,383,477	\$ 2,312,852
Cash and cash equivalents in noncurrent cash and investments	677,997	2,823,937
Total cash and cash equivalents	<u>\$ 7,061,474</u>	<u>\$ 5,136,789</u>

(continued on next page)

STATEMENTS OF CASH FLOWS - page 2

	<u>2006</u>	<u>2005</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
Operating income	\$ 3,266,408	\$ 2,588,817
Adjustments to reconcile operating income to net cash flows from operating activities		
Depreciation	4,152,445	3,830,350
Provision for bad debts	3,864,841	3,437,405
Changes in assets and liabilities		
Patient receivables, net of provision for bad debts	(5,020,509)	(3,648,502)
Other receivables	22,378	305,126
Supplies and other current assets	(74,166)	(706,876)
Accounts payable - trade	266,689	(163,010)
Estimated third-party payor settlements	119,338	(2,289,190)
Accrued expenses	271,542	233,146
Reserve for loss on general and professional liabilities claims	(95,000)	(75,000)
NET CASH FROM OPERATING ACTIVITIES	<u>\$ 6,773,966</u>	<u>\$ 3,512,266</u>

SUPPLEMENTAL DISCLOSURE OF CASHFLOW INFORMATION

The Healthcare System capitalized interest expense totaling \$17,672 and \$171,477 during 2006 and 2005.

The Healthcare System recognized \$8,750 of the deferred gain associated with the forward purchase contract (Note 15) during 2006 and 2005. These amounts are included in investment income on the accompanying financial statements.

DICKINSON COUNTY HEALTHCARE SYSTEM
(A Component Unit of Dickinson County)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006 AND 2005

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization

Dickinson County Healthcare System (Healthcare System) was formed as a county public Healthcare System in 1947. It was created to operate, control and manage all matters concerning Michigan's Dickinson County healthcare function. In 1990, the county public Healthcare System was reorganized as a health facilities corporation under Act 230 and assumed all rights, privileges, immunities and franchise of the predecessor county public Healthcare System. The Healthcare System provides acute, ambulatory, home health and certain physician services to the residents of its service area. The Board of County Commissioners approves the members of the Board of Trustees of the Healthcare System. The Healthcare System may not issue long-term debt without the County's approval. The Healthcare System is considered to be a component unit of Dickinson County.

The current Healthcare System facility was completed in 1996 on land leased from Dickinson County (County) under a one hundred year lease. Under provisions of the lease, title and ownership of all buildings and improvements constructed on the site are in the name of County. The lease places certain requirements and restrictions on the Healthcare System.

Dickinson County Healthcare System is accounted for as an enterprise fund of the County. The Healthcare System is exempt from federal and state income taxes under Section 115 of the Internal Revenue Code.

These financial statements include only the activity of the Healthcare System.

Enterprise Fund Accounting

The Healthcare System uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, as amended, the Healthcare System has adopted the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

The financial statements have been presented in conformity with generally accepted accounting principles as promulgated by GASB and as recommended in the Audit and Accounting Guide for Health Care Organizations published by the American Institute of Certified Public Accountants.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments, unless otherwise designated or restricted, with an original maturity of three months or less when acquired.

NOTES TO FINANCIAL STATEMENTS

Temporary Investments

Temporary investments include investments with an average maturity of three to twelve months, excluding internally designated and restricted cash and investments and other long-term investments. Temporary investments are recorded at fair value.

Patient Receivables

Patient receivables are uncollateralized patient and third-party payor obligations. Payments of patient receivables are allocated to the specific claims identified on the remittance advice or, if unspecified, are applied to the earliest unpaid claim.

The carrying amount of patient receivables is reduced by a valuation allowance that reflects management's estimate of amounts that will not be collected from patients and third-party payors. Management reviews patient receivables by payor class and applies percentages to determine estimated amounts that will not be collected from third parties under contractual agreements and amounts that will not be collected from patients due to bad debts. Management considers historical write off and recovery information in determining the estimated bad debt provision.

Supplies

Supplies are stated at lower of cost (first-in, first-out) or market.

Investments and Investment Income

Investments in debt and equity securities are reported at fair value. Fair value is determined based on quoted market prices, if available, or estimated fair value using quoted market prices for similar securities. Interest, dividends, gains and losses, both realized and unrealized, on investments in debt and equity securities are included in non-operating revenues when earned.

Internally designated funds consist primarily of U.S. Treasury securities and money market funds. Funds restricted under indenture agreement for debt service consists of a debt service reserve fund and principal and interest funds and are invested primarily in U.S. Treasury securities with maturities that match planned expenditures. Funds restricted under an indenture agreement for capital assets are invested primarily in money market and U.S. Treasury securities.

Funds that are available for obligations classified as current liabilities are reported in current assets.

Capital Assets

Capital asset acquisitions in excess of \$1,000 are capitalized and recorded at cost. Contributed capital assets are reported at their estimated fair value at the time of their donation. All capital assets other than land are depreciated or amortized (in the case of capital leases) using the straight-line method of depreciation using these asset lives:

Land improvements	5-20 years
Buildings and improvements	5-40 years
Equipment	3-20 years

NOTES TO FINANCIAL STATEMENTS

Costs of Borrowing

Except for capital assets acquired through gifts, contributions, or capital grants, interest cost on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. The Healthcare System capitalized \$17,672 and \$171,477 of interest cost in 2006 and 2005.

Deferred Financing Costs

Deferred financing costs are amortized over the period the related obligation is outstanding using the bonds-outstanding method.

Compensated Absences

The Healthcare System has a paid-time-off (PTO) program that allows employees to earn vacation and catastrophic leave (CAT) benefits based, in part, on length of service. Employees may accumulate PTO up to a specified maximum. Employees are paid for accumulated PTO if employment is terminated. The PTO program also allows for 25% of accumulated CAT days to be paid out at retirement up to a maximum of 120 hours. CAT days not paid out are applied to years of service for pension credit calculations.

Grants and Contributions

From time to time, the Healthcare System receives grants and contributions. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as non-operating revenues. Amounts restricted to capital acquisitions are reported after non-operating revenues and expenses.

Restricted Resources

When the Healthcare System has both restricted and unrestricted resources available to finance a particular program, it is the Healthcare System's policy to use restricted resources before unrestricted resources.

Net Assets

Net assets are presented in the following three components

Net Assets Invested in Capital Assets, Net of Related Debt - Invested in capital assets net of related debt consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets.

Restricted Expendable Net Assets - Restricted expendable net assets are non-capital net assets that must be used for a particular purpose, as specified by creditor, grantors, or contributors external to the Healthcare System, including amounts deposited with trustees as required by bond indenture agreements.

Unrestricted Net Assets - Unrestricted net assets are remaining net assets that do not meet the definition of "Invested in Capital Assets Net of Related Debt" or "Restricted."

NOTES TO FINANCIAL STATEMENTS

Net Patient Service Revenue

The Healthcare System has agreements with third-party payors that provide for payments to the Healthcare System at amounts different from its established rates. Payment arrangements include prospectively determined rates, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Operating Revenues and Expenses

The Healthcare System's statements of revenues, expenses, and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services - the Healthcare System's principal activity. Nonexchange revenues, including grants and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

Charity Care

To fulfill its mission of community service, the Healthcare System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Healthcare System does not pursue collection of amounts determined to qualify as charity care, they are not reported as patient service revenue (Note 3).

Advertising Costs

The Healthcare System expenses advertising costs as incurred.

Risk Management

The Healthcare System is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; medical malpractice; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

Reclassifications

Certain items in the prior year financial statements have been reclassified for comparability purposes with the current year financial statements. These reclassifications did not affect the financial position or results of operations as previously reported.

NOTE 2 - CHARITY CARE

The Healthcare System maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy and equivalent service statistics. The amounts of charges foregone, based on established rates, were \$1,582,819 and \$1,174,837 for the years ended December 31, 2006 and 2005.

(continued on next page)

NOTES TO FINANCIAL STATEMENTS

NOTE 3 - NET PATIENT SERVICE REVENUE

The Healthcare System has agreements with third-party payors that provide for payments to the Healthcare System at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare: Inpatient acute care and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per visit. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. The Healthcare System's Medicare cost reports have been settled by the Medicare fiscal intermediary through the year ended December 31, 2003. The Healthcare System's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Healthcare System.

Medicaid: Inpatient acute care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Defined capital costs are paid based on a cost reimbursement methodology for inpatient services. Outpatient services related to Medicaid program beneficiaries are reimbursed on a fee for service basis. The Healthcare System's Medicaid cost reports have been settled by the Medicaid fiscal intermediary through December 31, 1998.

Blue Cross: Inpatient and outpatient services rendered to Blue Cross subscribers are paid on a cost related methodology with final settlement determined after submission of annual cost reports by the Healthcare System and are subject to audits thereof by Blue Cross. The Healthcare System's Blue Cross cost reports have been settled by Blue Cross through December 31, 2005.

The Healthcare System has also entered into payment agreements with certain commercial insurance carriers and other organizations. The basis for payment to the Healthcare System under these agreements includes prospectively determined rates per discharge and discounts from established charges.

Laws and regulations governing the Medicare, Medicaid, and other programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

A summary of patient service revenue, contractual adjustments, and provision for bad debts for the years ended December 31, 2006 and 2005 is as follows:

	2006	2005
Gross patient service revenue	\$ 152,359,639	\$ 141,917,588
Less: charity care	(1,582,819)	(1,174,837)
Total patient service revenue	150,776,820	140,742,751
Contractual adjustments		
Medicare	(41,675,599)	(38,141,960)
Medicaid	(10,203,711)	(8,959,222)
Blue Cross	(20,724,130)	(20,668,040)
Other	(8,186,587)	(7,136,112)
	(80,790,027)	(74,905,334)
Provision for bad debts	(3,864,841)	(3,437,405)
Total contractual adjustments and provision for bad debts	(84,654,868)	(78,342,739)
Net patient service revenue	\$ 66,121,952	\$ 62,400,012

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NOTES TO FINANCIAL STATEMENTS

NOTE 4 - DEPOSITS, INVESTMENTS, AND INVESTMENT INCOME

Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Healthcare System's deposits may not be returned to it. The Healthcare System has a general investment policy to minimize custodial credit risk. The Healthcare System had bank balances at December 31, 2006 and 2005 as follows:

	2006	2005
Insured (FDIC)	\$ 120,114	\$ 119,036
Collateralized by corporate securities held by the pledging institution in the Healthcare System's name	1,000,000	1,000,000
Uncollateralized	7,462,961	1,704,399
Total	<u>\$ 8,583,075</u>	<u>\$ 2,823,435</u>
Carrying value	<u>\$ 6,383,477</u>	<u>\$ 2,312,852</u>

Investments

The Healthcare System's investments are reported at fair value. At December 31, 2006 and 2005, the Healthcare System's investments consisted of the following:

December 31, 2006

Investment Type	Carrying Amount	Investment Maturities (in Years)			
		Less Than 1	1-5	6-10	More Than 10
Money market funds	\$ 677,997	\$ 677,997	\$ -	\$ -	\$ -
Commercial paper	3,182,907	3,182,907	-	-	-
Federal National Mortgage Association	3,911,886	701,487	2,736,558	473,841	-
Federal Home Loan Mortgage Corporation	2,135,132	428,496	498,220	1,208,416	-
Federal Home Loan Bank	3,659,085	825,134	1,271,495	1,562,456	-
Federal Farm Credit Bank	1,069,339	250,235	245,158	573,946	-
U.S. Treasury Note	152,961	1,769	-	151,192	-
Other	3,813	3,813	-	-	-
Total	<u>\$ 14,793,120</u>	<u>\$ 6,071,838</u>	<u>\$ 4,751,431</u>	<u>\$ 3,969,851</u>	<u>\$ -</u>

NOTES TO FINANCIAL STATEMENTS

December 31, 2005

Investment Type	Carrying Amount	Investment Maturities (in Years)			
		Less Than 1	1-5	6-10	More Than 10
Money market funds	\$ 2,823,937	\$ 2,823,937	\$ -	\$ -	\$ -
Commercial paper	4,602,444	4,602,444	-	-	-
Federal National Mortgage Association	3,444,125	478,299	2,890,210	75,616	-
Federal Home Loan Mortgage Corporation	4,489,314	960,133	2,558,210	970,971	-
Federal Home Loan Bank	2,280,276	745,654	344,127	1,190,495	-
Federal Farm Credit Bank	694,158	375,635	242,890	75,633	-
U.S. Treasury Note	431,342	6,274	-	425,068	-
Other	7,882	7,882	-	-	-
Total	<u>\$ 18,773,478</u>	<u>\$ 10,000,258</u>	<u>\$ 6,035,437</u>	<u>\$ 2,737,783</u>	<u>\$ -</u>

Interest Rate Risk

The Healthcare System's investment policy contains a provision that limits the investment maturities of commercial paper to 270 days as a means of managing its exposure to fair value losses arising from increasing interest rates. The investment policy does not contain a provision that limits other types of investment maturities.

Credit Risk

Michigan Compiled Laws, Section 129.91, authorizes the Healthcare System to deposit and invest in accounts of federally insured banks, credit unions, and savings and loan associations which have an office in Michigan. The Healthcare System is allowed to invest in bonds, securities and other direct obligations of the United States or any agency or instrumentality of the United States; United States government or federal agency obligations; repurchase agreements; banker's acceptance of United States banks; commercial paper rated within the two highest classifications which mature not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions which are rated as investment grade; and mutual funds composed of investment vehicles which are legal for direct investment by local units of government in Michigan. The Healthcare System complies with State Statutes with regard to credit risk. As of December 31, 2006, the Healthcare System's investment in Federal Home Loan Bank, Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, US Treasury Notes, and Federal Farm Credit Bank are rated AAA by Moody's Investors Service.

Concentration of Credit Risk

The Healthcare System currently does not place a limit on the amount it may invest with any one issuer. More than 5 percent of the Healthcare System's investments are in the following investments as of December 31, 2006:

	Percentage
Commercial Paper	15.0%
Federal Home Loan Mortgage Corporation	10.0%
Federal National Mortgage Association	18.5%
Federal Home Loan Bank	17.3%
Federal Farm Credit Bank	5.1%

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NOTES TO FINANCIAL STATEMENTS

Custodial Credit Risk

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Healthcare System will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. At December 31, 2006 and 2005, all of the underlying securities for the Healthcare System's investments in U.S. government securities are held by the counterparties in other than the Healthcare System's name. The Healthcare System does not have a deposit policy for custodial credit risk.

Summary of Carrying Amounts

The carrying amounts of the Healthcare System's deposits and investments shown above are included in the balance sheets at December 31, 2006 and 2005 as follows:

	<u>2006</u>	<u>2005</u>
Carrying amount		
Deposits	\$ 6,383,477	\$ 2,312,852
Investments	<u>14,793,120</u>	<u>18,773,478</u>
Total	<u>\$ 21,176,597</u>	<u>\$ 21,086,330</u>
Included in the following balance sheet captions		
Cash and cash equivalents	\$ 6,383,477	\$ 2,312,852
Temporary investments	258,199	2,544,596
Restricted assets - current portion (Note 8)	1,256,346	1,214,440
Internally designated for capital improvements	7,088,984	10,170,625
Other long-term investments	4,103,694	1,070,196
Restricted under indenture agreement for debt service (Note 8)	2,085,897	2,361,138
Restricted under indenture agreement for capital assets	-	1,412,483
Total	<u>\$ 21,176,597</u>	<u>\$ 21,086,330</u>

Investment Income

Investment income and gains and losses on cash equivalents and investments consist of the following for the years ended December 31, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Interest income and realized gains and losses	\$ 821,888	\$ 732,002
Interest income on proceeds of borrowed funds	<u>169,797</u>	<u>178,719</u>
Total investment income	<u>\$ 991,685</u>	<u>\$ 910,721</u>
Change in unrealized gains and losses on investments	<u>\$ (21,321)</u>	<u>\$ (179,718)</u>

NOTES TO FINANCIAL STATEMENTS

NOTE 5 - CAPITAL ASSETS

Capital assets additions, transfers, retirements, and balances for the year ended December 31, 2006 are as follows:

	Balance December 31, 2005	Additions	Transfers and Retirements	Balance December 31, 2006
Capital assets not being depreciated				
Land	\$ 1,643,231	\$ -	\$ (20,019)	\$ 1,623,212
Construction in progress	1,793,120	2,317,661	(1,088,149)	3,022,632
Total capital assets, not being depreciated	<u>\$ 3,436,351</u>	<u>\$ 2,317,661</u>	<u>\$ (1,108,168)</u>	<u>\$ 4,645,844</u>
Capital assets being depreciated				
Land improvements	\$ 944,774	\$ 28,212	\$ -	\$ 972,986
Buildings and improvements	39,385,589	26,904	523,679	39,936,172
Equipment	30,139,473	2,089,492	(382,232)	31,846,733
Total capital assets being depreciated	<u>70,469,836</u>	<u>2,144,608</u>	<u>141,447</u>	<u>72,755,891</u>
Less accumulated depreciation for				
Land improvements	(214,694)	(46,220)	-	(260,914)
Buildings and improvements	(10,691,216)	(1,353,447)	6,612	(12,038,051)
Equipment	(17,395,980)	(2,752,778)	773,770	(19,374,988)
Total accumulated depreciation	<u>(28,301,890)</u>	<u>(4,152,445)</u>	<u>780,382</u>	<u>(31,673,953)</u>
Net capital assets being depreciated	<u>\$ 42,167,946</u>	<u>\$ (2,007,837)</u>	<u>\$ 921,829</u>	<u>\$ 41,081,938</u>
Capital assets, net	<u>\$ 45,604,297</u>	<u>\$ 309,824</u>	<u>\$ (186,339)</u>	<u>\$ 45,727,782</u>

Construction in progress at December 31, 2006, represents costs related to information technology and other equipment purchased and not placed into service. The total estimated cost to complete the projects is \$1,853,000, which will be funded with internally designated funds.

NOTES TO FINANCIAL STATEMENTS

Capital asset additions, transfers, retirements, and balances for the year ended December 31, 2005 are as follows:

	Balance December 31, 2004	Additions	Transfers and Retirements	Balance December 31, 2005
Capital assets not being depreciated				
Land	\$ 1,643,231	\$ -	\$ -	\$ 1,643,231
Construction in progress	3,205,926	6,311,131	(7,723,937)	1,793,120
Total capital assets, not being depreciated	<u>\$ 4,849,157</u>	<u>\$ 6,311,131</u>	<u>\$ (7,723,937)</u>	<u>\$ 3,436,351</u>
Capital assets being depreciated				
Land improvements	\$ 938,024	\$ 6,750	\$ -	\$ 944,774
Buildings	35,027,075	-	4,358,514	39,385,589
Equipment	26,179,359	1,732,523	2,227,591	30,139,473
Total capital assets being depreciated	<u>62,144,458</u>	<u>1,739,273</u>	<u>6,586,105</u>	<u>70,469,836</u>
Less accumulated depreciation for				
Land improvements	(169,642)	(45,052)	-	(214,694)
Buildings	(9,421,031)	(1,270,185)	-	(10,691,216)
Equipment	(15,767,769)	(2,515,113)	886,902	(17,395,980)
Total accumulated depreciation	<u>(25,358,442)</u>	<u>(3,830,350)</u>	<u>886,902</u>	<u>(28,301,890)</u>
Net capital assets being depreciated	<u>\$ 36,786,016</u>	<u>\$ (2,091,077)</u>	<u>\$ 7,473,007</u>	<u>\$ 42,167,946</u>
Capital assets, net	<u>\$ 41,635,173</u>	<u>\$ 4,220,054</u>	<u>\$ (250,930)</u>	<u>\$ 45,604,297</u>

NOTES TO FINANCIAL STATEMENTS

NOTE 6 - OPERATING LEASES

The Healthcare System leases certain medical and other equipment and office space under operating leases having terms of more than one year. Total operating lease expense in December 31, 2006 and 2005 for all leases was \$433,979 and \$486,128.

Minimum future lease payments for these operating leases are as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
2007	\$ 239,146
2008	97,789
2009	83,052
2010	75,861
Total minimum lease payments	<u>\$ 495,848</u>

NOTE 7 - LONG-TERM DEBT

Long-term debt consists of:

	<u>Balance December 31, 2005</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance December 31, 2006</u>	<u>Amounts Due Within One Year</u>
Hospital Revenue Bonds, Series 2004	\$ 4,873,820	\$ -	\$ (101,070)	\$ 4,772,750	\$ 106,941
Hospital Revenue and Refunding Bonds, Series 1999	30,595,000	-	(925,000)	29,670,000	975,000
Original issue discount	(235,551)	-	20,429	(215,122)	-
Equipment note payable	1,085,992	-	(188,365)	897,627	199,983
Unamortized loss on defeasance of Series 1994 Bonds	(2,720,505)	-	235,947	(2,484,558)	-
	<u>\$ 33,598,756</u>	<u>\$ -</u>	<u>\$ (958,059)</u>	<u>\$ 32,640,697</u>	<u>\$ 1,281,924</u>

NOTES TO FINANCIAL STATEMENTS

	Balance December 31, 2004	Additions	Reductions	Balance December 31, 2005	Amounts Due Within One Year
Hospital Revenue Bonds, Series 2004	\$ 4,969,340	\$ -	\$ (95,520)	\$ 4,873,820	\$ 101,070
Hospital Revenue and Refunding Bonds, Series 1999	31,470,000	-	(875,000)	30,595,000	925,000
Original issue discount	(256,573)	-	21,022	(235,551)	-
Equipment notes payable	1,263,414	-	(177,422)	1,085,992	188,365
Capitalized lease obligations	56,064	-	(56,064)	-	-
Unamortized loss on defeasance of Series 1994 Bonds	(2,963,299)	-	242,794	(2,720,505)	-
	<u>\$ 34,538,946</u>	<u>\$ -</u>	<u>\$ (940,190)</u>	<u>\$ 33,598,756</u>	<u>\$ 1,214,435</u>

Long-Term Debt

The terms and due dates of the Healthcare System's long-term debt, including capital lease obligations, at December 31, 2006 and 2005 are as follows:

- 5.66% Dickinson County Healthcare System, County of Dickinson, State of Michigan, Hospital Revenue Bonds, Series 2004 (Series 2004 Bonds) - due in monthly installments of \$31,194 including interest, to August 2029, secured by certain equipment. (1)
- 5.50% to 5.80% Dickinson County Healthcare System, County of Dickinson, State of Michigan, Hospital Revenue and Refunding Bonds, Series 1999 (Series 1999 Bonds) - Due in varying annual installments to November 2024, secured by a pledge of net revenues, investment income, and bond funds held under the indenture agreement (Note 4). (1)
- Original Issue Discount - Associated with the Series 1999 Bonds issuance.
- Equipment Note Payable - Megavoltage Radiation Therapy (MRT) equipment – During 2000 the Healthcare System entered into a 6%, 10-year note payable with Marquette General Hospital (an unrelated organization) for the purchase of MRT equipment. The note payable is due in monthly installments of \$20,700 to January 2011, and is secured by the MRT equipment
- Unamortized Loss on Defeasance of Series 1994 Bonds – During 1999, the Healthcare System defeased the Series 1994 Revenue Bonds by issuing the Series 1999 Bonds. A portion of the Series 1999 Bond proceeds totaling \$32,810,599 was placed in an irrevocable trust to provide for all future debt service payments on the 1994 bonds. Accordingly, the trust accounts' assets and liabilities for the defeased bonds are not included in these financial statements. The resulting loss on defeasance of approximately \$4,480,000 is being amortized using the straight-line method, over the life of the Series 1999 Bonds.

(1) The Series 2004 Bonds and Series 1999 Bonds loan agreements places limits on the incurrence of additional borrowings and requires the Healthcare System satisfy certain measures of financial performance. The Series 1999 Bonds loan agreement also requires the Healthcare System maintain certain deposits with a trustee. Such deposits are shown as restricted for this purpose in the balance sheets (Note 5).

NOTES TO FINANCIAL STATEMENTS

Scheduled principal and interest payments on long-term debt are as follows:

<u>Year Ending December 31,</u>	<u>Long-Term Debt</u>		<u>Total</u>
	<u>Principal</u>	<u>Interest</u>	
2007	\$ 1,281,924	\$ 2,003,889	\$ 3,285,813
2008	1,355,471	1,931,717	3,287,188
2009	1,475,139	1,855,399	3,330,538
2010	1,540,998	1,772,391	3,313,389
2011	1,379,638	1,691,425	3,071,063
2012-2016	8,101,452	7,225,319	15,326,771
2017-2021	10,686,273	4,639,534	15,325,807
2022-2026	8,600,853	1,321,669	9,922,522
2027-2029	918,629	72,742	991,371
	<u>35,340,377</u>	<u>\$ 22,514,085</u>	<u>\$ 57,854,462</u>
Less unamortized bond discount	(215,122)		
Less unamortized loss on defeasance	<u>(2,484,558)</u>		
Total	<u>\$ 32,640,697</u>		

NOTE 8 - DEFINED BENEFIT PENSION PLAN

A. Plan Description

The Healthcare System is the administrator of a single-employer defined benefit noncontributory pension plan (Plan) covering substantially all of its employees who have met the Plan's eligibility requirements. The Plan was established in 1965 and most recently amended January 1, 2004. The most recent actuarial valuation was made as of January 1, 2007. Based on actuarial information, the Healthcare System's estimated payroll for employees covered by the Plan for the years ended December 31, 2006 and 2005 was approximately \$28,334,000 and \$27,447,000. The Healthcare System's total actual payroll for the years ended December 31, 2006 and 2005 was approximately \$31,039,000 and \$29,118,000.

Current membership in the Plan consists of the following at December 31:

	<u>2006</u>	<u>2005</u>
Retirees and beneficiaries currently receiving benefits	183	177
Vested terminated members	132	132
Active and inactive employees		
Fully vested	523	511
Nonvested	<u>162</u>	<u>153</u>
	<u>1,000</u>	<u>973</u>

All employees of the Healthcare System are eligible to participate in the Plan following the completion of at least one year of service and a minimum of 1,000 hours. Benefits vest after five years of service and a minimum of 1,000 hours per year.

NOTES TO FINANCIAL STATEMENTS

Normal retirement age is 65 with the completion of five or more years of service. Normal retirement pays a monthly pension for life, equal to 1.25% of average monthly compensation per year of credited service plus 0.65% of average monthly compensation in excess of covered compensation per year of service up to a maximum of 35 years, with a \$50 minimum. Participants may elect an early retirement on or after age 60 which pays a monthly pension for life computed in the same manner as a normal retirement pension, but based on service and earnings to date of retirement, and actuarially reduced to reflect the early commencement date.

Active employees with 15 or more years of service and who have attained age 50, who become disabled are eligible for a disability pension, provided they qualify for Social Security disability. A disability pension is computed in the same manner as a normal retirement pension, but based on service and earnings to the date of disability.

If a vested employee dies, a death benefit is paid to the surviving spouse. Fifty percent of the deceased employee's benefit accrued to the date of death, is paid immediately or at the date the employee would have been age 60, whichever is later.

Funding Policy

The Plan's funding policy provides for periodic employer contributions at actuarially determined rates that, expressed as percentages of annual covered payroll, are designed to accumulate sufficient assets to pay benefits when due. The required contributions for the years ended December 31, 2006 and 2005 were 5.58% and 5.24%, of annual covered payroll.

Annual Pension Cost

For 2006, 2005, 2004, 2003, and 2002, the Healthcare System's annual pension cost was equal to the Healthcare System's required and actual contributions. The required contribution was determined as part of the January 1, 2006, 2005, 2004, 2003, and 2002, actuarial valuations using the projected unit credit cost actuarial funding method. The actuarial assumptions for fiscal 2006 included (a) 8.5% investment rate of return and (b) salary increases including merit and seniority increases ranging from 0.16% to 3.84% per year, plus wage inflation of 5.0%. The assumptions regarding benefits are that no changes will occur on a postretirement basis.

The Healthcare System's annual pension cost, and required and actual contributions for the years ended December 31, 2006, 2005, 2004, 2003, and 2002 were approximately \$1,582,000, \$1,437,000, \$1,267,000, \$1,048,000 and \$873,000. The net pension obligation for the years ended December 31, 2006, 2005, 2004, 2003, and 2002 was zero.

A separately issued financial report of the Dickinson County Healthcare System Retirement Plan is available which includes financial statements and required supplementary information for the Plan.

NOTE 9 - DEFERRED COMPENSATION PLAN

The Healthcare System offers its employees a deferred compensation plan (DC Plan) created in accordance with the Internal Revenue Code, Section 457 and administered by Lincoln Retirement Services Company, LLC (Lincoln). The DC Plan is available to all employees and permits them to defer a portion of their current earnings from income taxes until withdrawal in retirement, upon death, withdrawal upon termination at the employee's option, or withdrawal due to an unforeseeable emergency.

NOTES TO FINANCIAL STATEMENTS

The assets of the DC Plan are held in trust for the exclusive benefit of participants and beneficiaries under the DC Plan, in accordance with Internal Revenue Code, Section 457 (g). Wilmington Trust Company, a Lincoln Affiliate, is the Trustee. Participants or surviving beneficiaries under the DC Plan may allocate their fund balances among independently managed mutual funds Lincoln's Alliance Program and a fixed annuity provided by Lincoln.

In accordance with the provisions of GASB Statement No. 32, the DC Plan assets and activities are not reflected in the financial statements of the Healthcare System.

NOTE 10 - GENERAL AND PROFESSIONAL LIABILITY INSURANCE

The Healthcare System carries general and professional liability insurance through MHA Insurance Company. General and professional liability claims are insured on a claims-made policy covering claims in excess of \$50,000 per occurrence and \$150,000 in the aggregate.

The Healthcare System has exposure to deductibles for professional liability claims and a liability for such claims has been established based upon an actuarial determination of expected losses on an occurrence basis.

The Healthcare System's estimate of general and professional liability includes a provision for known claims and for unreported claims and incidents. The Healthcare System's liability for unreported and known claims and incidents has been recorded at the total of anticipated future payments, and is discounted at a present value factor of 4% for 2006 and 2005. Amounts included as expense for general and professional liability for the years ended December 31, 2006 and 2005 were approximately \$617,000 and \$595,000. The reserve for loss on professional liability claims at December 31, 2006 and 2005 and activity for the years then ended is as follows:

Balance December 31, 2004	Additions	Reductions	Balance December 31, 2005	Additions	Reductions	Balance December 31, 2006
\$ 965,000	\$ -	\$ (75,000)	\$ 890,000	\$ -	\$ (95,000)	\$ 795,000

NOTE 11 - LITIGATION, CLAIMS, AND DISPUTES

The Healthcare System is subject to the usual contingencies in the normal course of operations relating to the performance of its tasks under its various programs. In the opinion of management, the ultimate settlement of litigations, claims, and disputes in process will not be material to the financial position of the Healthcare System.

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations, specifically those relating to the Medicare and Medicaid programs, can be subject to government review and interpretation, as well as regulatory actions unknown and unasserted at this time. Recently, federal government activity has increased with respect to investigations and allegations concerning possible violations by health care providers of regulations, which could result in the imposition of significant fines and penalties, as well as significant repayments of previously billed and collected revenues from patient services. Management believes that the Healthcare System is in substantial compliance with current laws and regulations.

NOTES TO FINANCIAL STATEMENTS

NOTE 12 - CONCENTRATIONS

The Healthcare System grants credit without collateral to its patients, most of who are insured under third-party payor agreements. The mix of receivables from third-party payors and patients at December 31, 2006 and 2005 was as follows:

	2006	2005
Medicare	34%	37%
Blue Cross	17%	17%
Medicaid	7%	6%
Commercial insurance and other	23%	21%
Self pay	19%	19%
	<u>100%</u>	<u>100%</u>

The Healthcare System is subject to collective bargaining agreements for approximately 64 percent of its labor force. These agreements are negotiated on a tri-annual basis. The agreement for the Michigan Nurses Association will expire in May of 2008. The agreement for the American Federation of State, County, and Municipal Employees (AFSCME) will expire in December of 2009.

NOTE 13 - DICKINSON COUNTY HOSPITAL FOUNDATION

Dickinson County Hospital Foundation (Foundation) is organized to raise funds for the benefit of the Healthcare System and the community. The Foundation is deemed not to be a component unit of the Healthcare System as defined in GASB 39, *Determining Whether Certain Organizations Are Component Units*, as the economic resources received or held by the Foundation is not considered significant to the Healthcare System. As the Foundation is not considered a component unit, the Foundation's financial statements are not included in these financial statements. At December 31, 2006 and 2005, the Foundation's assets consisted primarily of cash and short-term investments and totaled approximately \$439,000 and \$345,000. During 2006 and 2005, the Foundation transferred funds totaling \$8,279 and \$197,000 to the Healthcare System. These amounts are included in capital contributions on the accompanying financial statements.

NOTE 14 - FORWARD PURCHASE CONTRACT/DEFERRED GAIN

A forward purchase contract was entered into in 1999 by the Healthcare System relating to certain trustee held funds associated with the Series 1999 bonds. The contract provides a fixed rate of return of 5.775% on the Debt Service Fund and the Reserve Fund investments (Note 4).

The contract has a maturity date of November 2024, a notional value of approximately \$2,848,000 and \$2,853,000 as of December 31, 2006 and 2005, respectively, and an estimated fair value of approximately \$280,000 and \$392,000 at December 31, 2006 and 2005, respectively.

Upon inception of the agreement, the Healthcare System received a premium of \$220,000 from the counter party, which is being amortized over the life of the debt, and is recorded as a deferred gain.

The Healthcare System believes its credit risk is minimal on the transaction.



CPAs & BUSINESS ADVISORS

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

To the Board of Trustees of
Dickinson County Healthcare System

We have audited the financial statements of Dickinson County Healthcare System (the "Healthcare System") (a component unit of Dickinson County) as of and for the year ended December 31, 2006, and have issued our report thereon dated April 5, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Healthcare System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Healthcare System's internal control over financial reporting.

Our consideration of the internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Healthcare System's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Healthcare System's financial statements that is more than inconsequential will not be detected by the Healthcare System's internal control over financial reporting.

A material weakness is a significant deficiency or combination of significant deficiencies that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by Healthcare System's internal control.

We noted no matters involving the internal control over financial reporting and its operation that we consider to be significant deficiencies or material weaknesses. However, we noted an other matter involving the internal control over financial reporting that we have reported to management of the Healthcare System in a separate letter dated April 5, 2007.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Healthcare System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Trustees, management of the Healthcare System, and the State of Michigan and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Eric Bailey" followed by the letters "LLP". The signature is written in a cursive, flowing style.

Fargo, North Dakota
April 5, 2007